

RELATIONSHIP BETWEEN BANKS CHARACTERISTICS AND SHUBUHAT: THE CASE OF ISLAMIC BANKS IN MALAYSIA

ESSIA RIES AHMED

**UNIVERSITI SAINS MALAYSIA
2012**

**RELATIONSHIP BETWEEN BANKS
CHARACTERISTICS AND SHUBUHAT: THE CASE OF
ISLAMIC BANKS IN MALAYSIA**

By

ESSIA RIES AHMED

**Thesis Submitted in Fulfillment of the Requirements
for the Degree of Master of Art**

**UNIVERSITI SAINS MALAYSIA
February 2012**

DEDICATION

This thesis, in one way or another, is a reflection and translation of prayers, doa, love, cares, sacrifices, inspiration, moral support, by most valued assets blessed by Allah Almighty. Thus, this special and humble dedication came sincerely from the bottom of my heart to these special persons.

To my father, Almighty God's mercy and my mother, may Allah Almighty prolong her life with health and wellness... Amen. May Allah give me the time and the power to recoup and repay to both of you.

To my brothers, my sisters, and my wife who had made so much sacrifices, support and encouragement to me throughout my life, no words could precisely express and describe how grateful I am to be associated with all of you. And to my beloved son Alzubair.

ACKNOWLEDGEMENTS

Praise be to Allah the Al-Mighty and Merciful for without His blessings it would not be possible to complete this research. I would like to express my deepest gratitude to my supervisors Assoc. Prof. Dr. Sofri Yahya and Dr. Md. Harashid Haron for the guidance, advises and support during preparation of this study, and helping me to understand the whole concept and processes of doing a research.

TABLE OF CONTENTS

DEDICATION	i
ACKNOWLEDGEMENTS	ii
TABLE OF CONTENTS	iii
LIST OF TABLES	viii
LIST OF FIGURES	x
LIST OF GLOSSERY	xii
ABSTRAK	xiii
ABSTRACT	xv
CHAPTER 1 - INTRODUCTION	1
1.0 Introduction	1
1.1 Study Background	1
1.2 Problem Statement	7
1.3 Research Objectives	13
1.4 Research Questions	14
1.5 Significance of the Study	14
1.6 Scope of the Study	15
1.7 Organization of the Remaining Chapters	16
CHAPTER 2 - LITERATURE REVIEW	17
2.0 Introduction	17
2.1 <i>Maqasid Al Shariah</i> and business	17
2.2 Islamic Banking in Malaysia.....	22
2.3 Business activities which may be exposed to doubtful deeds.....	26
2.4.1 Halal and Haram in Islamic Shariah.....	29
2.4.2 Defining <i>al Shubhat</i> :.....	32
2.4.3 Shubuhah Arises out of Mixture.....	49

2.4.4 Determinants of <i>Shubuhah</i>	57
2.4.5 Summary of Definition of <i>Shubuhah</i>	59
2.5 Benchmarks of mixing by the <i>Shariah</i> Advisory Council of the Securities Commission Malaysia	59
2.6 Parameters and Criteria of <i>Shubuhah</i> from Islamic Banking Perspective	63
2.6.1 Mixture-proportion measurements in <i>Shubuhah</i>	66
2.6.2 Methods of financial analysis to determine <i>Shubuhah</i> mixture	67
2.6.3 Operational Definition of <i>Shubuhah</i>	70
2.7 Banks Characteristics	71
2.7.1 Chairman of the Bank	76
2.7.2 <i>Shariah</i> Supervisory Board (SSB)	77
2.7.3 Percentage of Muslim Shareholders	83
2.7.4 Type of Bank	85
2.7.5 Orientation of Bank	86
2.8 Summary	88
CHAPTER 3 - THEORETICAL FRAMEWORK.....	90
3.0 Introduction	90
3.1 Theoretical Base of the Study	90
3.1.1 Theory of Indebtedness (<i>Al-Mithaq</i>).....	91
3.1.2 Theory of Agency	92
3.2 <i>Shubuhah</i>	94
3.4 The Relationship between <i>Shubuhah</i> and Banks' Characteristics	95
3.4.1 The Relationship between <i>Shubuhah</i> and Chairman of the Bank	95
3.4.2 The Relationship between <i>Shubuhah</i> and <i>Shariah</i> Supervisory Board	96
3.4.3 The Relationship between <i>Shubuhah</i> and Percentage of Shareholders	97

3.4.4 The Relationship between Shubuhah and Type of Bank.....	98
3.5.5 The Relationship between Shubuhah and Orientation of Bank.....	99
3.5 Theoretical Framework	101
3.6 Development Hypotheses	102
3.7 Summary	103
CHAPTER 4 - METHODOLOGY	104
4.0 Introduction	104
4.1 Research Design.....	104
4.1.1 Type of study	104
4.1.2 Population and Sample size	105
4.1.3 Source of data	106
4.1.4 Method and justifications of Interview	107
4.1.4 Unit of analysis and Data Collection	108
4.2 Variables	109
4.2.1 Measurement of Variables	109
4.2.2 Measurement of Dependent Variable	109
4.2.3 Measurement of Independent Variables	111
4.3 Data Analysis Techniques.....	113
4.4 Summary	113
CHAPTER 5 - RESULTS AND FINDINGS	114
5.0 Introduction	114
5.1 Definition of Shubuhah.....	114
5.2 Population versus sample	120
5.3 Islamic Banks Characteristics	121
5.3.1 Chairman of the Bank.....	121

5.3.2 Percentage of Muslim Shareholders	121
5.3.3 <i>Shariah</i> Supervisory Board.....	122
5.3.4 Type of Bank	123
5.3.5 Bank Orientation.....	123
5.4 Descriptive Statistics on <i>Shubuhah</i> of Finance and Revenue	124
5.4.1 Method of analyzing the structure of finance in order to determine the proportion of the <i>Haram</i> mixture.	124
5.4.2 Method of analyzing elements of income and expenses to estimate the ratio of income mixing haram	125
5.5 Correlation Analysis.....	126
5.6 Descriptive Regression Analysis.....	127
5.7 Hypotheses Testing	133
5.8 Summary	136
CHAPTER 6 - DISCUSSION AND CONCLUSION	137
6.0 Introduction	137
6.1 Recapitulation of the Study	137
6.2 Definition of <i>Shubuhah</i> from Islamic Banking perspectives	137
6.3 <i>Shubuhah</i> of Finance and Revenue	140
6.4 Bank's characteristics and the <i>Shubuhah</i>	142
6.4.1 The Impact of Chairmen of Islamic Bank on <i>Shubuhah</i>	143
6.4.2 The Impact of Muslim Shareholders of Bank on <i>Shubuhah</i>	144
6.4.3 The Impact of <i>Shariah</i> Supervisory Board of Bank on <i>Shubuhah</i>	145
6.4.4 The Impact of Type of Bank on <i>Shubuhah</i>	147
6.4.5 The Impact of Orientation of Bank on <i>Shubuhah</i>	148
6.5 Implication	150

6.5.1 Theoretical perspective	150
6.5.2 Practical Perspective	151
6.6 Limitation	152
6.7 Recommendation for Future Research	152
6.8 Conclusion	152
REFERENCES	154
APPENDIX A	160
APPENDIX B	161
APPENDIX C	163
APPENDIX D	201

LIST OF TABLES

Table 2.1	: Islamic Tenets of Business Transactions	22
Table 2.2	: Conditions of Necessities	32
Table 2.3	: Opinion of Classification	38
Table 2.4	: Range Activities which raise Doubts	47
Table 2.5	: Things in Terms of Provision	49
Table 2.6	: Matters of Doubts	50
Table 2.7	: Mixed of Quantity	67
Table 4.1	: Islamic Banks in Malaysia	106
Table 5.1	: Summary of Definitions (Previous Literature)	116
Table 5.2	: Summary of <i>Shubuhah</i> (<i>Shihatah</i> Interview)	116
Table 5.3	: Summary of Definitions (Previous Interviews)	118
Table 5.4	: Comparing of Definitions (Previous Literature & Interview)	119
Table 5.5	: Mixed Financial Quantity	120
Table 5.6	: Chairman of Banks	121
Table 5.7	: Percentage of Shareholders	122
Table 5.8	: Statistics of SSB	122
Table 5.9	: <i>Shariah</i> Supervisory Board	123
Table 5.10	: Type of Bank	123
Table 5.11	: Bank Orientation	124
Table 5.12	: <i>Shubuhah</i> of Finance	125
Table 5.13	: <i>Shubuhah</i> of Revenue	126
Table 5.14	: Guides of Cohen related to Correlation straight	126
Table 5.15	: Correlation between Variables	127
Table 5.16	: R Square of Finance <i>Shubuhah</i> (Chairman)	129

Table 5.17	: Regression of <i>Shubuhahat</i> (Finance & Revenue) (cairman)	129
Table 5.18	: R Square of Finance <i>Shubuhahat</i> (SSB)	130
Table 5.19	: Regression of <i>Shubuhahat</i> (Finance & Revenue) (SSB)	130
Table 5.20	: R Square of Finance <i>Shubuhahat</i> (Shareholders)	131
Table 5.21	: Regression of <i>Shubuhahat</i> (Finance & Revenue) (Shareholder)	131
Table 5.22	: R Square of Finance <i>Shubuhahat</i> (Type of bank)	132
Table 5.23	: Regression of <i>Shubuhahat</i> (Finance & Revenue) (Type)	132
Table 5.24	: R Square of Finance <i>Shubuhahat</i> (Oreintion)	133
Table 5.25	: Regression of <i>Shubuhahat</i> (Finance & Revenue) (Oreintion)	133
Table 5.26	: Testing Hypotheses for <i>Shubuhahat</i> (Finance & Revenue)	134
Table 5.27	: Results of Hypotheses Testing	135

LIST OF FIGURES

Figure 2.1	: The <i>Shariah</i>	18
Figure 2.2	: Places of Doubts	53
Figure 2.3	: <i>Shubuhah</i> in <i>Shariah</i>	56
Figure 3.1	: Theoretical Framework	102

LIST OF GLOSSERY

Terms	Definitions
<i>Shariah</i>	Islamic Law
<i>Halal</i>	Permissible
<i>Haram</i>	Forbidden
<i>Riba</i>	Usury
<i>Gharar</i>	Ambiguity
<i>Maisir</i>	Gambling
<i>Muzara'ah</i>	Sharecropping
<i>Musaqah</i>	Tending to crops in exchange for a share of the proceeds
<i>Ijarah</i>	Rent
<i>Jihad</i>	Striving in the way of Allah
<i>Shubuhah</i>	Doubtful
<i>Aqidah</i>	Faith
<i>Akhlaq</i>	Ethics
<i>Muamalat</i>	Interactions
<i>Fardh</i>	Required
<i>Salat</i>	Prayers
<i>Sawm</i>	Fasting during the Month of Ramadhan
<i>Zakat</i>	Islamic tax
<i>Mustahabb</i>	Recommended
<i>Mubah</i>	Indifferent
<i>Makruh</i>	Reprehensible
<i>Ulama</i>	Religious Scholars

<i>Uqud al-ta'men</i>	Insurance Contracts
<i>Al-qeam al-islamia</i>	Islamic Values
<i>Fiqh</i>	Jurisprudence
<i>Mujtahed</i>	A scholar qualified to issue rulings
<i>Iltibas</i>	Confusion
<i>Quias</i>	Analogy
<i>Istishab</i>	Accompanying
<i>Ausol</i>	Origins
<i>Jahala</i>	Fraud
<i>Almithaq</i>	Indebtedness

PERHUBUNGAN ANTARA CIRI-CIRI BANK DAN *SYUBHAH*: KES BANK ISLAM DI MALAYSIA.

ABSTRAK

Syariah Islam menetapkan peraturan dalam mentadbir serta menjelaskan perkara yang berkaitan dengan ekonomi, sosial, politik dan budaya kehidupan masyarakat Islam, termasuklah institusi kewangan mereka. Prinsip Islam melarang segala aktiviti yang boleh mendatangkan bahaya kepada peniaga dan pengguna dalam pasaran serta masyarakat secara keseluruhannya. Adalah penting bahawa semua aktiviti urusan niaga dan perniagaan hendaklah mematuhi hukum syarak bagi menghindari daripada aktiviti yang boleh mendatangkan keraguan. Objektif utama penyelidikan ini adalah untuk menjelaskan pengertian *Syubhah* dari perspektif perbankan Islam, dan menentukan perkaitan di antara beberapa Bank Islam yang terpilih, berdasarkan ciri-ciri berikut: pengurus beragama Islam atau bukan beragama Islam, SSB, pemegang saham beragama Islam, jenis bank dan orientasi bank dengan *Syubhah*. Kajian ini dijalankan berdasarkan data primer (temu bual) dan data sekunder (laporan tahunan) yang terkumpul.

Kajian ini mengkonsepkan semula definisi *Syubhah* terutamanya yang berkaitan dengan bank Islam dan menyelidik pelbagai variabel / pemboleh ubah yang memberi impak terhadap penglibatan *Syubhah* dalam perbankan Islam. Penyelidikan ini mengetengahkan definisi *Syubhah* berdasarkan dapatan daripada kajian lepas, temu bual dengan ilmunan agama dan definisi yang digunakan dalam kajian. Sehingga Mac 2010, terdapat sejumlah 21 bank Islam di Malaysia. Laporan tahunan 2010 dianalisis menggunakan program SPSS. Penyelidikan mendapati bahawa ciri-ciri bank yang mempengaruhi *Syubhah* boleh digunakan sebagai rujukan dalam

menentukan kewujudan *Syubhah* dalam bank Islam. Semua ciri bank yang ditemui menunjukkan perkaitan dengan *Syubhah*. Berdasarkan dapatan kajian, perbincangan tentang dapatan semasa serta implikasi kajian dari segi teori dan praktikal dibentangkan dalam penyelidikan ini.

RELATIONSHIP BETWEEN BANKS CHARACTERISTICS AND SHUBUHAT: THE CASE OF ISLAMIC BANKS IN MALAYSIA

ABSTRACT

Islamic Shariah establishes rules which govern and define the economic, social, political and cultural life of Islamic societies, including their financial institutions. Islam, in principle, prohibits all activities that cause harm to the dealers and consumers in the market as well as the society as a whole. It is very important that all dealings and business activities must abide by the rules of Islamic law so as to avoid all doubtful activities. The primary objectives of this research are to define *Shubuhath* from the Islamic Banking perspectives and to determine the relationships between selected Islamic banks based on the following characteristics; Muslim or non-Muslim chairman, SSB, Muslim shareholders, type of bank and bank orientation and *Shubuhath*. This study was conducted based on primary data (interviews) and secondary data (annual reports) collection.

This study aims to re-conceptualize the definition of *Shubuhath* especially with regard to Islamic banks and to investigate variables that have impacts on the involvement of *Shubuhath* in the Islamic Banks. This study also highlights the synthesized *Shubuhath* definition from the previous studies as well as the interviews on *Shubuhath* with religious experts and consequentially the operational definition used in the study. The total list of Islamic Banks is 21 banks, as in March 2010. The annual reports were collected in cross-sectional year 2010 and analyzed using the SPSS program. The research found that the selected banks' characteristics influence *Shubuhath* could be used as subjects of references in determining the existence of *shubuhath* in Islamic banks. All the banks' characteristics were found to be inversely related to *shubuhath*.

Based on the findings, the discussions of the existing findings as well as the theoretical, practical implications of the study are presented in this paper.

CHAPTER 1

INTRODUCTION

1.0 Introduction

This chapter gives a brief description to the layout of this thesis. Section 1.1 presents the background of the study, Section 1.2 explains the problem statement, Section 1.3 provides the research objectives, Section 1.4 describes the questions of the study, Section 1.5 discusses the significance of the study, Section 1.6 discusses the scope of the study, and finally Section 1.7 discusses the organization of the remaining chapters.

1.1 Study Background

The Islamic *Shariah* ordains seeking *halal*, not only as it is pure in itself, but also for its overall benefits to society as a whole, affecting food, drink or any other activities, particularly economic activities (earning and consumption).

Similarly, the *shariah* ordains the avoidance of *haram*, in any form or activity regardless of its nature of purpose, because it is impure and harmful to society. *Halal* is what the *shariah* has made lawful, and *haram* is what the *shariah* has made unlawful, otherwise considered harmless (Al-Gazzalli, d.111). Allah (swt) has laid down ordinances that must be followed, and has set boundaries that must not be transgressed, while matters not addressed, were not forgotten, but deliberately done out of his mercy to mankind. So it is imperative that these matters are assumed to be permissible without the necessity to enquire about them.

There are some objectives for *Shariah* in Islam. The primary objectives that *Shariah* tends to realize are the protection and preservation of religion, life, progeny, property, intellect and honour. The main objectives of Islamic laws could lead to a number of secondary goals of all aspects of life. Under *Shariah* principles, all business activities and transactions taking place in the capital market should be free from prohibited activities such as usury (*riba*), ambiguity (*gharar*), gambling (*maisir*) and doubtful (Shubuhah). According to *Iqbal* (1997), investing in interest-based financial institutions is not allowed in *shariah* intact, compliant companies are expected to offer activities and services base on the code of Islamic ethics and must function within the limits of *Shariah*.

The Islamic *shariah* has laid out in detail and outlined clearly what is *haram* both through the Quran and the *sunnah*. Therefore Allah (swt) says in the Holy Quran, in *surat Al An'am*: 38, "... we have not left out anything in the Book." Similarly in *surat Al Nahl*: 44, "and we have revealed upon you that by which you may make clear to the people what has been revealed and so that they may reflect." And in *surat Al An'am*: 119, "... and it has been made clear to you that which has been forbidden except what you have been forced to."

Further reason to show the importance of seeking goodness in earning is that Allah (swt) has ordered all Muslims, male or female, to seek goodness. He says in *Surat Al Mu'minun*: 51, "O messengers! Eat of the good things and do good; surely I know what you do" as well as *surat Al Baqarah*: 172, "O you who believe! Eat of the good things that we have provided you with, and give thanks to Allah if Him it is that you worship".

Indeed Allah (swt) has bestowed great bounty on mankind by sending Mohammad (PBUH) as a Prophet in order to make all good things lawful for them, and make all impure things unlawful, and to remove the chains that were imposed on previous nations. Allah (swt) says in *surat Al Araf*: 157: “Those who follow the Messenger-Prophet, the Ummi, whom they find written down with them in the Taurat and the Injeel (who) enjoins them good and forbids them evil, and makes lawful to them the good things and makes unlawful to them impure things, and removes from them their burden and the shackles which were upon them; so (as for) those who believe in him and honor him and help him, and follow the light which has been sent down with him, these it is that are the successful”.

As the good things are those that are enjoyed and desired by those with balanced souls, and sought after by the people of good character. And that is *halal* as long as it fulfils its requirements as is the case with slaughter and its requirements (*Al-Gazzalli*, d.111).

Whenever a thing is deemed unlawful in Islam there is always a lawful alternative that achieves the same benefit at the same time attaining a superior state. For instance, Islam forbids adultery, but instead allows marrying two or three or four wives. And while it is unlawful to steal, it is encouraged to earn, similarly, interest is forbidden but it is permissible to form all sorts of lawful partnerships, such as *qiradh* (*mudharabah*) and *muzara'ah* (sharecropping) and *musaqah* (tending to crops in exchange for a share of the proceeds) and others. In addition it has been made permissible to buy and sell (*bay'*) and to rent (*ijarah*) as well as forward sale (*salam*)...etc.

Furthermore, the Prophet (PBUH) warned against unlawful earnings and mentioned that if a person were to be fed with *haram* and dressed in *haram*, Allah (swt) would not accept his efforts, even if they were of the highest and most sacred form of worship and the most painstaking, such as *jihad* (striving in the way of Allah). For it has been narrated by Imam Muslim, that the Prophet (PBUH) mentioned a man stepping out for jihad, dishevelled and dusty, raising his hands up to the sky saying: "O Allah!" and his food is from *haram* and his drink is from *haram* and his clothes are from *haram*, how will his prayer be answered? Imam Ahmad narrated that the Prophet (PBUH) said to his companion, *Sa'ad ibn Abi Waqqas*, "*O Sa'ad make pure your sustenance, your prayers will be answered*"(Muslim, 2/228).

Thus, a Muslim is expected to seek *halal* to earn his income while going about his various activities, especially economic activities (earning and consumption) and to invest excess funds and offer (as charity) accordingly. Similarly, he is expected to distinguish *haram* in order to refrain from and escape it and purify his earnings and investments and offerings.

Fortunately, it is by the grace of Allah (swt) that *halal* is obvious and naturally accepted by instinctively good souls, and that *haram* is obvious and avoided by people of sound nature. However, the problem lies in that there is an area in between that leaves a devout Muslim in uncertainty and worry, wanting to know how the *shariah* classifies it. Those are matters few people know for certain though it is clear to scholars. It is an area which closely resembles *halal*, or closely resembles *haram*, such as *bay' al ainah*, *tawaruq*, *arbun* ... etc.

According to the principles of *Shariah*, all business activities must be in accordance to rules and regulations of *Shariah* and any activity against these rules and regulations will be *Haram* in Islam. Therefore business activities are very essential in *Shariah* compliance criteria, and here business activities are referred those business deal only clear businesses and not dealing with *Shubahat* (El-Gamal, 2000).

It's troublesome define to precisely clear and unclear issues in business activities because similarities between them exist. The agreed-upon *Hadith* states “What is lawful is clear and what is unlawful is clear, but between them are certain doubtful things which many people do not recognize. Who guards against the doubtful things keeps his religion and his honour blameless (*Al-Bukhari & Muslim*)”. Explaining this *Hadith*, *Alasqlani* states that its identicalness to each other where the verdict was not evident. However, *Ibn Mandhour* states that the similarities than problems' matters. When Imam Ahmad was asked about *Shubuhath*, he replied that it is status between *Halal* and *Haram* and a Muslim, who wants to keep his religion, should not approach it. Although in *Shariah*, *Halal* and *Haram* are strictly decided, between the statuses of *Halal* and *Haram* *Shubuhath* exists. However, this status of *Shubuhath* is only known by scholars in *Shariah*. This is supported by *Hadith* mentioned above as it states that “between them are certain doubtful things which many people do not recognize”. Therefore, it is not easy for many people to recognize doubtful activities that exist in the middle between *Halal* and *Haram*. Subsequently, Muslims should avoid *Shubuhath* because it is a status that Muslims may get involved in it .

It is worth mentioning here that studies focusing on doubtful businesses in Islam are few. However, some researchers, such as Imam *Ghazzali*, have highlighted the *Shubuhah*. In his book, *Ihya-Ulum-Id-Din*, *Al-Ghazali* (1096-7) mentions doubtful activities in general, and then divided the money into *Halal* and *Haram*. Also specified the ranking of the doubts activity and places, this book by Imam *Ghazali* is very important because he rooted and divided the doubts things on the basis of Islamic *Shariah* law. *Al-Qaradawi*, (1997) emphasizes that types of money are either *Halal* or *Haram*. He calls for avoiding such doubtful activities based on *Hadith* given in *Al-Bukhari*. In another Study, *Aziz* (2009) focused on what he calls clear business and unclear business and applied these terms to *Shariah*-complaint companies in Bursa Malaysia. One of the major findings of *Aziz* (2009) is that 90.8% of the activities are clear business while 9.2% are unclear business; this means that these companies which deal with unclear business have got some doubtful business.

This thesis would extend the study of *shubuhah* to Islamic banking. Having known that Islamic finance and banking are the most regulated industry, arguably, complying with the dictates of *shariah* should not be on issue. The focus is then on improving the compliance to *shariah* by assessing the degree of the existence of *shubuhah* in Islamic banking. In essence, this study pioneers the value chain introduction of *shariah* compliance. In order to improve the Islamic finance and banking industry, the industry players should move up the value chain of *shariah* compliance by focusing on *shubuhah* existences continuing the existence of *shubuhah*. The lesser the existence of *shubuhah* signifies the higher the value chain of *shariah* compliance.

1.2 Problem Statement

Today, Islamic banking has become an undeniable reality. The number of Islamic banks and financial institutions are forever increasing. New Islamic banks with large amount of capitals are being established. Conventional banks are opening Islamic windows or Islamic subsidiaries for the operations of Islamic banking. Even the non-Muslim financial institutions are entering the field and trying to compliments each other's business in order to attract as many Muslims and non- Muslim customers as they can. It seems that the size of Islamic banking will be multiplied during the next decade and the operations of Islamic banks are expected to cover a large area of financial transactions of the world (Usmani, 2002)

Although the Islamic banking system is different from the conventional banking system; there are some similarities between them. For instance, an Islamic bank conducts its activities in accordance with the Islamic *Shariah* principle that strictly prohibit any payment or receipt of interest. However, the Islamic bank can also offer products and services which are similar to those offered by a conventional bank (Gerre and Cunningham, 2001). The difference mainly lies in the manner the banking transactions are conducted and the way money is mobilized and recorded.

Nowadays, the institutions of Islamic banking operate in a very competitive and demanding industry. In order to survive in this challenging environment, they should be able to meet their customers' financial needs. Innovation of product is seen as the key successful factor to maintain current growth of business. Interestingly, the new products development can be seen more extensively in the institutions of banking in South-east

Asia when compared to innovation within the Middle East.

Malaysia is considered to be one of the key players in the Islamic finance industry, not only in Asia, but also globally. Malaysian government has introduced many rules and regulations that are complying with the provisions of Islamic *Shariah* (Mohamed, 2008). Islamic financial system in Malaysia has seen significant growth in terms of demand and acceptance and development since it was first introduced in 1963. It started from a modest beginning with the establishment of the Malaysian Pilgrims Fund Board *Tabung Haji* in 1963 which is considered the first Islamic financial institution in Malaysia (Thahirah, 2009). After that, several Islamic institutions were established including Islamic Bank of Malaysia in 1983, followed by development of Islamic money market in 1993. *Shariah* approved securities were listed in the Kuala Lumpur Stock Exchange in June 1997.

Malaysia, as a centre for the largest market in the world of Islamic bonds, has worth of approximately \$ 47 billion. Malaysia has achieved significant success in Islamic Finance which at the end of June 2009, accounted for close to 19 % of the country's banking assets. In addition to that at the end of -August, the Islamic capital markets have reached RM803 billion, representing 54 percent of Bursa Malaysia's market capitalization. While total financing now amounts to RM115 billion and constitutes 15.5 percent of the total financing portfolio of the banking industry, net non-performing financing remains low at 2.4 per cent (*BERNAMA*, 2009).

In Malaysia, in order to ensure that activities and all operations of Islamic financial institutions do not contradict with *Shariah*, the *Shariah* Advisory Council (SAC), *Shariah* Supervisory Committee (SSC) or *Shariah* Supervisory Board (SSB) normally functions as advisors or supervisors of Islamic banking activities. In addition, Bank Negara Malaysia (BNM) has also issued the relevant guidelines to ensure prudent regulation of *Shariah* matters in Islamic financial institutions. Internationally, there is the Islamic Financial Services Board (IFSB) and the Accounting and Auditing Organizations of Islamic Financial Institutions (AAOIFI) have issued a number of governance standards and guidelines (Abdul Rahim, 2008).

The industry of Islamic finance and banking has grown significantly over the past thirty years. According to Bank Negara, the total of financing was RM 133,482.3 million, for Islamic Banking Scheme data which represents Islamic Banking System (IBS) of Commercial and Investment/Merchant banks in December 2009. (www.bnm.gov.my).

Therefore, it is essential to build on this great development in order to make the Islamic finance industry succeed, and at the same time trying to increase public knowledge in matters of *Shariah*. In order to improve the industry of Islamic banking and increase the confidence of the public, practices based on interest should be eliminated (E1 Qorchi, 2005). Thus, the Islamic world needs to find some alternative finance models compliant with *Shariah* and free of doubtful or forbidden activities (Aziz, 2009).

Islamic *Shariah* covers all aspects of life; Muslims must comply with the provisions of the Islamic *Shariah*. Based on the exploratory study (see appendix B) there are tarnishes and things that are unclear and not compliance with the Islamic *Shariah* known as *Shubuhah*, (i.e. *Shubuhah* matters). These *Shubuhah* do not have a clear working definition and explicit form due to two reasons: first, differences in definition among scholars with regard to *Shubuhah* (Yousef, 1990). Second, according to *sharaih*, the *Shubuhah* is not known or are not clearly identified by many people. Literature shows no consensus between researchers that, what constitute *Shubuhah* or doubtful in Islamic banking perspective (Yousef 1990). This is prompted research to study the definition of *Shubuhah* for Islamic banks' pipeline, which become the first objective of the research.

Many institutions in Islamic countries, particularly in Malaysia, use a dual system, namely a full-fledged Islamic banking system operating on a parallel basis with a full-fledged conventional system. Not only do the two systems work on a parallel basis, they also utilize essentially the same set of banking infrastructure (Nor & Mohamed, 2003; Mohamed, 2008). Thus, doubtful matters unfortunately do exist.

There are a lot of doubtful things and controversial issues such as “*Bai' Al I'na*, *Bai' Al Tawwaruq*, Commercial Insurance, Short selling, Pricing and The interest received due to depositing savings in government deposit funds” (Yusuf, 1990), particularly those institutions that are using both systems. This will affect the Muslim customers' confidence, if these institutions are not committed to comply with the law, one of the major inherent risks of Islamic bank's business is (risk of *Shariah* incompliance).

According to Islamic epistemology, *Shariah* compliance is composed of *halal* (permissible), *haram* (forbidden) and *shubuhah* consistent with the *hadith* "*The halal is clear and the haram is clear, in between there are doubtful deeds, not many people knowing them. For he who avoids them has achieved purity of religion and reputation. And he who falls in the doubtful deeds falls into haram, just like a shepherd guarding a sanctuary nearly resting in it. Indeed for every kingdom there is a sanctuary, and the sanctuary of Allah is His boundaries; and indeed in everybody there is a structure that if corrected will correct the entire body, and if corrupted, will corrupt the entire body; indeed it is the heart*" (Bukhari 1/295) (Muslim 11/28) (Imam Ahmad, Al Musnad 4/269).

Halal and *haram* have been widely researched and well-understood in the Islamic finance and banking industry, but not *shubuhah*. As a matter of fact, it is not only *shubuhah* but also factors influences *shubuhah*. As such, this thesis will focus on *shubuhah*. Particularly of Islamic banking and some selected factors containing it.

Admittedly, there are a host of factors influencing *shubuhah*, but as an exploratory study, this research will only investigate characteristics of the Islamic banks, such as chairman of bank, shareholders, *shariah* supervisory board, type of bank and orientation of bank. The reasons being, arguably, they are the significant characteristics with which customers, Islamic banks and regulators will look at in determining the Islamic banks' compliance to *Shariah*. Furthermore, the selected characteristics are very general in nature and readily available in the bank's annual reports.

As this research, to the author's knowledge, is of the pioneer in studying *shubuhah* in Islamic banking, there is a pressing need to define *shubuhah* with respect to Islamic banking first before determining the relationship with above-mentioned factors.

The chairman of a bank has a big role in influencing the policy of the company in general. The chairman of an organization hold the power and responsibility in ensuring his company complies with the *Shariah* requirement (Aziz, 2009).

The safeguard to make Islamic banks perform their dealings according to the *shariah* comes when there is a legitimate control body known as *shariah* supervisory board (SBB) in the bank (Lahsana, 2010). A *Shariah* Supervisory Board (SSB) normally consists of *fiqh muamalat* experts to guide their operations and transactions in accordance with the rules of *Shariah*. Therefore, *Shariah* Supervisory Board undoubtedly forms the most important and influential entity in any Islamic financial institution (Mass R, 2010) to be *shariah*-compliant and better containing *shubuhah*.

Muslim Shareholders, on the other hand, could affect the policies of the bank under the so-called concentration of property (Shleifer & Vishny, 1986b cited in Shleifer & Vishny, 1997). If the bank's shareholders majorities are Muslims they may influence the bank to comply with *Shariah* rules. And, in return, their customers will have a higher satisfaction, (Aziz, 2009) to customers.

Type of bank (local & international) is now expected to compete effectively on level terms with international best players (BNM, 2001).there is strong competition not only

between local and international Islamic banks but also non-Islamic rivals (Mujani, 2011). The type of bank may influence the bank to comply with *Shariah*.

Bank orientation (Full-fledged subsidiary), Islamic banks can fully orientate all of their activities to the Islamic ideals; while the subsidiary Islamic banks cannot, since they are still a part of their holding banks, i.e. conventional banks. Full-fledged Islamic banks are more efficient than Islamic windows. While Islamic windows of international banks tend to be more efficient than those of local banks (Mokhtar & Abdullah & AL-Habashi, 2006). Therefore, the orientation has influence to comply with Islamic rules.

Therefore, basis on the discussion above, the present study will firstly determine the definition of *Shubuhah* from an Islamic Banking perspectives, and secondly the relationship between the selected bank's characteristics and *shubuhah*.

The present study hypothesize that there is a relationship between *shubuhah* and Islamic Banks characteristics. There is still a lack of specialized studies of *Shubuhah* in the literature; much less Islamic Banks, especially with regard to factors influencing the *Shubuhah*. Hence, this research will be a pioneer in this regard. In summary, the research problem of the study can be stated as the following: “what the working definition of *shubuhah* in the Islamic banks perspective is; and what the extents of influences of selected Islamic banks characteristics on *shubuhah* are”.

1.3 Research Objectives

Based on the problems reiterated above, the following two objectives are established:

1. To define *Shubuhah* from Islamic Banking perspectives.

2. To determine the relationships between Islamic banks characteristics (Muslim or non-Muslim chairman, SSB, Muslim shareholders, type of bank and bank orientation) and *shubuhahat*.

1.4 Research Questions

Following the preceding objectives, six research questions are consequently developed namely:

1. What is the working definition of *Shubuhahat* from Islamic Banking perspectives?
2. Is there any relationship between chairman of bank (Muslim or non-Muslim) and the *shubuhahat*?
3. Is there any relationship between *shariah* supervisory board and the *shubuhahat*?
4. Is there any relationship between percentage of Muslim shareholders and the *shubuhahat*?
5. Is there any relationship between type of bank (local & international) and the *shubuhahat*?
6. Is there any relationship between bank orientation (full-fledged & subsidiary) and the *shubuhahat*?

1.5 Significance of the Study

This study will contribute, firstly, in view the lack of studies relating the concept and definition of *shubuhahat*, to a working definition on *Shubuhahat* from Islamic banking perspectives, and it is a novel study since there are no previous studies, as to the author's knowledge, have covered this area from the Islamic banking perspectives.

Secondly, this study introduce a value chain of *shariah* compliance by adding the element *shubuhah* to the general understanding of *shariah* compliance which has been generally understood as having the elements of *halal* and *haram*.

Thirdly, this study uncovers several factors influencing *shubuhah* in Islamic banks, namely chairman of bank, shareholders, *shariah* supervisory board, type of bank and orientation of bank.

Fourthly, this study also would contribute to provide clarification on the Shubuhah fundamentals for further investigations and with more detailed description of the *Shubuhah*.

Finally, this study contributes to both academic and practitioner individuals. The findings may have some policy implications whereby the policy is made (*shariah* advisory council, Islamic banks management).

1.6 Scope of the Study

The Islamic Banks in Malaysia have been chosen primarily because these banks play a significant role in the development of Islamic finance industry in the country in general (M, Yacop 2010).

This study will focus on the relationship between *Shubuhah* and some selected characteristics (i.e. chairman of the bank, *Shariah* Supervisory Board (SSB), Percentage of Muslim Shareholders, type of bank and orientation of bank).

1.7 Organization of the Remaining Chapters

The present study consists of six chapters. The first chapter is an introductory one includes the background to the study, research problem, research objectives, and research questions. Significance of the study and scope of the study are also presented in this chapter.

The second chapter reviews studies related to the purposes of the present study. While the third chapter focuses on the theoretical framework and the research hypotheses.

The fourth chapter focuses on the research design of the present study. It starts with a discussion of methods that will be employed for collecting data. Procedures of data collection and the variables of the present study are also discussed in this chapter. In addition, the fourth chapter presents a detail discussion on the techniques and procedures for the analysis of data collected.

The fifth chapter presents the overall findings of study. It summarizes the statistics of the annual report, results of the statistical analysis and it also provides the results of the hypotheses testing.

The sixth chapter concludes the study by discussing the findings. Also provide the implications of this study. Recommendations for future research are also suggested in this chapter.

CHAPTER 2

LITERATURE REVIEW

2.0 Introduction

The present chapter deals with reviewing studies related to the present study. This chapter focuses on the literature pertaining to Halal and *Haram*, literature's definitions of *shubuhah*, places of *Shubuhah*, doubtful business activities, evidence of *Shubuhah*, the mixing of money, and finally synthesized definition of *shubuhah* from the literature. The related literature will also explain the inter relationships between *shubuhah* and banks characteristics.

2.1 *Maqasid Al Shariah* and business

The *Shariah* encourages behaviours which reflect the basic values of Islam, including cooperation, thrift, responsibility and economic and social justice. The objectives of *Shariah* known in Islamic law as "*Maqasid As-Shariah*" which protect humankind from any problem whether it's in the financial system or other aspects of life. The commitment to Islamic law in the context of any action or decision leads to the final outcome of the objectives of *Shariah* "*Maqasid As-Shariah*". These *Maqasid* are five: a) Preservation of the Religion. b) Preservation of Life. c) Preservation of Intellect. d) Preservation of Property. e) Preservation of Progeny. The provisions and rules of *Shariah* revolve around these objectives. In Figure 2.2 next, the nature of *Shariah*, objectives of *Shariah* and sources of *Shariah* are presented.

It's very essential that all dealings and activities in business must avoid Shubuhah and also should be compliant to the rules of *Shariah*. For example, Muslims are required to work in *Halal* activities because "*Shariah* is a body of legal principles derived from Quran, the teachings of the prophet Mohammed (PBUH) and interpretations of those teachings by Islamic jurisprudential scholars" (Masudi, 2005). *Shariah* generally predicts benefits to individual and community, and its laws are designed to protect these benefits and facilitate the improvement and perfection of the conditions of human life on earth (Kamali, 2007).

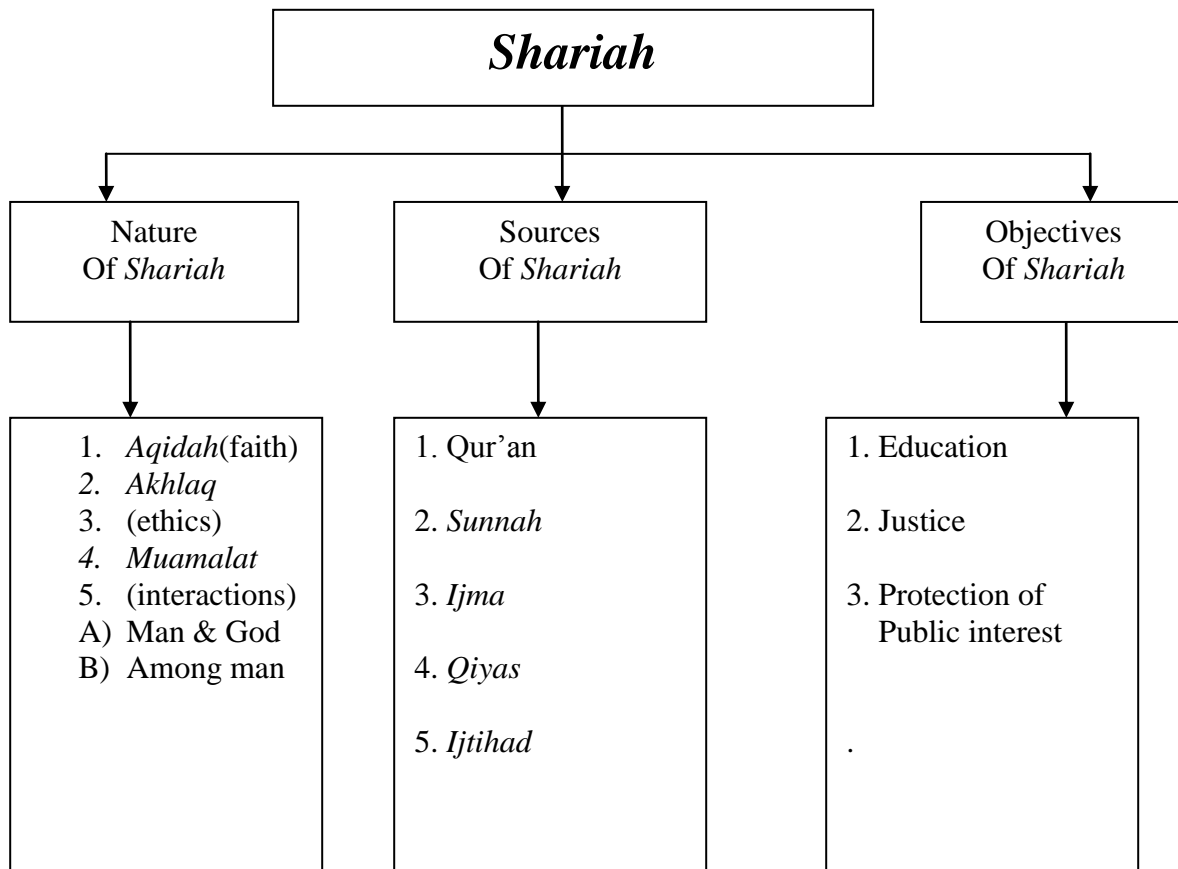


Figure 2.1 The *Shariah* (Rosly 2007)

Under the principles of *Shariah*, transactions taking place in the capital market should be free from prohibited activities such as usury (*riba*), ambiguity (*gharar*) and gambling (*maisir*), and also the profit cannot be generated from prohibited activities such as alcohol production, pornography, and gambling (Iqbal, 1997). Ayub (2008) provides definitions for the terms of *riba*, *maisir* and gambling.

Riba is an excess or increase. It means an increase over the principal in a loan transaction, over a debt or in exchange transaction, accrued to the lender/creditor or a party to exchange without giving an equivalent counter value or recompense in return to the other party. The Holy Qur'an mentioned that *riba* is prohibited. The Quran read what means:

“And for their taking Riba although it was forbidden for them, and their wrongful appropriation of other people's property. We have prepared for those among them who reject faith a grievous punishment.” (Quran 4:161)

Also the Prophet (PBUH) prohibits Muslim from involved in *riba*. He said:

“When one of you grant a loan and the borrower offers him a dish, he should not accept it; and if the borrower offers a ride on an animal, he should not ride, unless the two of them have been previously accustomed to exchanging such favours mutually.” (Anas ibn Malik).

Either evidence of the prohibition of *maisir*. The Qur'an read what means:

“O you who believe! Intoxicants and gambling, sacrificing to stones, and divination by arrows, are abominable actions of Satan; so abstain from them, that you may prosper”.(Quran 5:90)

Islam fully recognizes the desirability of engagement in business activities. It is a religion that is pro-business. The Qur'an states:

“Allah has made business lawful for you”

(Qur'an, Sura Al Baqarah-2: 275).

Islam has its own distinctive value-based ethical system for business dealings. This system prescribes certain specific guidelines governing business ethics. It

- (i) Enumerates the general ethical rules of business conduct,
- (ii) Identifies ethically desirable forms of business, and,
- (iii) Specifies the undesirable modes of transactions.

In describing the moral code of Islam, it is important to understand that actions can be categorized according to their degree of permissible (*Halal*) and forbidden (*Haram*). Nothing is prohibited (*Haram*) except what is prohibited by a sound and explicit verse of the Qur'an or a clear and authentic *Sunnah* (practice or saying) of the Prophet Mohammed (PBUH). In Islamic jurisprudence (*Fiqh*), five such classes are identified: *Fardh*, *Mustahabb*, *Mubah*, *Makruh*, *haram*.

Fardh (required) represents the class of actions that are mandatory on every person claiming to be a Muslim, such as *Salat* (prayers), *Sawm* (fasting during the month of *Ramadhan*) and *Zakat* (Islamic tax).

Mustahabb (recommended) describes the class of actions that are not obligatory but highly recommended for Muslims, such as supererogatory fasting beyond *Ramadhan*, praying *Nawafil*, etc.

Mubah (indifferent) actions are those that are neither mandatory nor forbidden, such as having personal preference for one type of *halal* (permissible) food over another or a Muslim may like to garden.

Makruh (reprehensible) actions are that is less in degree of prohibition than *Haram* (prohibited), and In Islamic terminology, something, which is makruh is a disliked or offensive act (literally "hated"). Though it is not *haram* (forbidden) and therefore, not a sin, a person who abstains from this action will be rewarded. An example of something *makruh* is the use of a great amount of water for the large (ghusl) and small (wudu), the ritual washings known as the *wudu* and *ghusl*. Muslims are encouraged to avoid such actions when possible.

Haram (prohibited) actions are unlawful and prohibited action and committing them is a major sin. Such actions include murder, adultery, drinking alcohol, and so further. There are some business activities of lawful (*Halal*) and unlawful (*Haram*) in aspect of the transactions (Jawed, 2007).

Table 2.1: Islamic Tenets of Business Transactions

<i>Halal</i> Business Transactions	<i>Haram</i> Business Transactions
Keenness to earn Legitimate (<i>Halal</i>) Earnings	Interest (<i>Riba</i>)
Trade through Mutual Consent	Dealing in Prohibited (<i>Haram</i>) Items
Truthfulness	Sale of <i>Al-Gharar</i> (Uncertainty, Risks, Speculation)
Generosity and Leniency	Arbitrarily Fixing the Prices
Trustworthiness	Hoarding of Foodstuff
Honouring and fulfilling Obligations (<i>Uqud</i>)	Exploitation of one's Ignorance of Market Conditions
Fair Treatment of Workers	Cheating and Fraud

Source: Jawed 2007

2.2 Islamic Banking in Malaysia

Malaysia is an Islamic country, the government has introduced facilitative regulatory and good supervisory framework on business activities that conform to the Islamic law of *Shariah* with Islamic financial market in 1993 being one of the examples (Aziz, 2009). Currently, Malaysia is moving to the next level of *Shariah* compliant era where government is now seriously putting many rules and incentives to encourage companies to be active participants in *Shariah* compliant. Cooperating with some organizations such as Securities Commissions, Bursa Malaysia, Bank Negara Malaysia and some other financial institutions, the Malaysian government has introduced varieties of product choices for Islamic finance. This extended to Islamic financial product traded in capital market which is a market where activities are carried out in ways that do not conflict with the principles of Islam. In Malaysia, this Islamic capital market is monitored by *Shariah* Advisory Council (hereafter SAC). It was established by the

Securities Commission in 1996 under section 18 of the Securities Commission Act 1993 (SC, 2007). The SAC was given the mandate to ensure that the running of Islamic Capital Market complies with the principles of *Shariah*.

The Islamic window concept, which started in March 1993 as a result of the Central Bank of Malaysia or Bank Negara Malaysia (BNM) introducing the “Interest-Free Banking Scheme”, was one of the operations of the major starting operations of Islamic banking system in Malaysia in 1983, when the first Islamic bank, Bank Islam Malaysia Berhad (BIMB) commenced its operations. This is because it was the objective of the government to develop Islamic banking system parallel to the existing conventional banking one. Therefore, instead of establishing many new Islamic banks, the concept of ‘Islamic window’ was introduced by the government, as a means of allowing the existing conventional banks to introduce Islamic banking products to their customers. As one of the Muslim countries, Malaysia was thus committed not only in developing Islamic banking system but also a complete Islamic financial system. Twenty-one Islamic financial products were developed to cater for this scheme with only three major banks initially participating, but by July of the same year, the scheme was extended to all financial institutions in Malaysia. By the end of year 2000, two Islamic, seventeen domestic commercial, five merchant banks and seven discount houses represented the Islamic banking system. Also included are four foreign-owned banks providing Islamic banking products and services.

The step towards developing a complete Islamic financial system started when both Islamic capital market and Islamic money market were fostered. Islamic capital market

started when the Malaysian government issued Islamic bonds in 1983 and to further enhance the development of the capital market, Islamic private debt securities were introduced.

In 1994, BIMB Securities was established as the first Islamic stockbroker in Malaysia and formed the first step towards promoting Islamic equity market. Aside from providing Islamic broking houses and Islamic managed funds, a separate “Islamic Index” was also established. This index comprised 179 permissible stocks on the Kuala Lumpur Stock Exchange (New Horizon, 1996).

Muslim investors invested directly in permitted (*halal*) counters. Securities firms which were conventional, also initiated their Islamic stock broking windows to advise investors on *halal* stocks. As at July 1996, 364 stocks were considered *halal*, of the total 633 listed on the Kuala Lumpur Stock Exchange (KLSE). On 17 April 1999, the KLSE *Sharia* Index was introduced, to enable public investment in line with the *Sharia* law. In January 1994, the BNM also boosted the growth of Malaysian Islamic financial system further, by initiating an Islamic inter-bank money market, which is considered the first Islamic money market in the world, which traded funds worth RM301.9 billion in the year 2000 (BNM Annual Report, 2000).

A major role is also played by Malaysia in developing an international Islamic financial system. As a first step, the realigning of Labuan from being an offshore financial center to an international Islamic financial centre was undertaken, which resulted in the first international Islamic financial market to be established in Labuan at the end of 2001.

The financial turmoil of 1997 and the liberalization of the world banking system resulted into Malaysia developing a ten-year plan known as 'Financial Sector Stability'. The plan aimed to create a more efficient and competitive, innovative, technology-driven and strategically more focused financial system. Included in the plan was for Islamic financial system to be one of the components which could further be developed to become a key player in Malaysian and international banking sectors. However, even though supported by the government via the introduction of various mechanisms to develop the Islamic financial system, the success it has recorded so far is significantly influenced by the market players. The market share of Islamic banking assets, deposits and financing reflects public acceptance of this system.

Malaysia has a significant number of full-fledged Islamic banks including several foreign owned entities conventional institutions who have established Islamic subsidiaries and also entities who are conducting foreign currency business (www.mifc.com 17 Jan 2011). Today, Malaysia has a full-fledged Islamic financial system operating parallel to conventional financial system. In terms of products and services, there are more than 40 different Islamic financial products currently available in a country. Currently 11 full-fledged Islamic banks (local and foreign) are operating in Malaysia. There are also 8 Islamic windows by conventional banks that were given licence to operate in Malaysia. Type of bank is very important in the Islamic Shariah because there are some business activities in which under Islamic Shariah are prohibited, namely *riba*, *Shubuhah*, Gambling, Pornography, Alcohol, Tobacco, and all other businesses that are prohibited under *Shariah* law.